

Internal Revenue Service

Number: **201013026**
Release Date: 4/2/2010
Index Number: 106.00-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:TEGE:EB:HW
PLR-137543-09

Date:
December 08, 2009

Legend

City =

City Council =

Plan and Trust =

Dear :

FACTS

City is a political subdivision of State. City established Plan and Trust to fund payment of post-employment medical insurance premiums for eligible employees. Trust is governed by a board of Trustees consisting of City Treasurer, Finance Director, a City Council member and two City residents.

The Trustees will accept and account for the contributions from the City, will keep contributions separate from other City operating funds, will invest and reinvest the contributions, and will make payments to retired employees for the exclusive benefit of retired employees and for the purpose of paying for post-employment medical benefits. The amounts of the payments are determined by a formula described in Plan and are used to pay a portion of health insurance premiums. Employees or former employees of the City may not contribute funds to the Trust in connection with their post-employment medical benefits. Contributions to the Trust are irrevocable unless improperly contributed. City, through Trust, will (1) reimburse each eligible retired employee directly for City's share of the retired employee's medical insurance premium

upon proof of payment of premium; or (2) will provide the retired employee with a check payable to the retired employee's medical insurer for City's share of premium, which the retired employee must then turn over to the medical insurer.

City does not provide benefits under Plan and Trust to individuals who do not qualify as a retiree's spouse or dependent under §152 of the Internal Revenue Code (the Code). Retired employees may not make pre-tax contributions to pay for medical benefits. Neither active employees nor retirees have the option to cash out amounts in Plan (i.e., eligible retirees may not receive cash or other taxable benefits in lieu of post-retirement medical benefits). Sick or vacation benefits may not be converted to retiree medical benefits. All retiree medical benefits terminate (1) 36 months after the death of the retired employee; or (2) 36 months after the date the employee's age and years of service equal 70, except in the case of a surviving spouse or dependent who is permanently disabled during the life of the employee.

Trust income will include City contributions and investment income. No portion of the principal or income of Trust shall be used for or diverted to any purpose other than the payment of Plan benefits and the reasonable expenses incurred in the supervision and administration of Trust. Private interests will neither participate in nor benefit from the operation of Plan and Trust other than as providers of goods or services for reasonable compensation.

The Trust agreement may be amended at any time by an ordinance adopted by City Council, except that no amendment may authorize any part of Trust corpus or income to be used for or diverted to, purposes other than the exclusive benefit of Plans' participants or the payment of Trust expenses. Trust is irrevocable. Further, Plan and Trust may be terminated at any time by the trustees, provided there are no participants eligible for Plan and Trust benefits. Upon termination of Plan and Trust and satisfaction of all liabilities of Trust, any remaining assets shall be returned to City. In no event will Trust assets be distributed to an entity that is not a state, a political subdivision of a state or an entity the income of which is excluded from gross income under § 115 of the Code.

LAW AND ANALYSIS

Section 115(1) of the Code provides that gross income does not include income derived from any public utility or the exercise of an essential governmental function and accruing to a state or a political subdivision of a state.

In Rev. Rul. 77-261, 1977-2 C.B. 45, income from an investment fund, established under a written declaration of trust by a state, for the temporary investment of cash balances of the state and its participating political subdivisions, was excludable from gross income for federal income tax purposes under § 115(1). The ruling indicated that the statutory exclusion was intended to extend not to the income of a state or

municipality resulting from its own participation in activities, but rather to the income of a corporation or other entity engaged in the operation of a public utility or the performance of some governmental function that accrued to either a state or municipality.

The ruling stated that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out projects that are desirable from the standpoint of a state government and which are within the ambit of a sovereign properly to conduct. The ruling concluded that because the participating political subdivisions have an unrestricted right to receive in their own right their proportionate share of the investment fund's income as it is earned, the fund's income accrues to them within the meaning of § 115(1).

In Rev. Rul. 90-74, 1990-2 C.B. 34, the Service determined that the income of an organization formed, funded, and operated by political subdivisions to pool various risks arising from their obligations regarding public liability, workers' compensation, or employees' health is excludable from gross income under § 115. In this ruling, private interests did not materially participate in the organization, nor did they benefit more than incidentally from the organization.

Plan and Trust provide health benefits to retired employees of City, a political subdivision of State. Providing health benefits to current and retired government employees constitutes the performance of an essential government function. Based upon Rev. Rul. 90-74 and Rev. Rul. 77-261, Plan and Trust perform an essential governmental function within the meaning of § 115(1) of the Code

The income of Trust accrues to City and the benefit to the participating employees is incidental to the public benefit. See Rev. Rul. 90-74.

Section 61(a)(1) of the Code and § 1.61-21(a)(3) of the Income Tax Regulations provide that, except as otherwise provided in Subtitle A of the Code, gross income includes compensation for services, including fees, commissions, fringe benefits, and similar items.

However, section 106(a) of the Code provides that gross income of an employee does not include employer-provided coverage under an accident or health plan.

Section 1.106-1(a) of the regulations provides that the gross income of an employee does not include contributions which his employer makes to an accident or health plan for compensation (through insurance or otherwise) to the employee for personal injuries or sickness incurred by him, his spouse, or his dependents, as defined in § 152. The employer may contribute to an accident or health plan either by paying the premium (or a portion of the premium) on a policy of accident or health insurance covering one or more of his employees, or by contributing to a separate trust or fund (including a fund referred to in § 105(e)) which provides accident and health benefits directly or through insurance to one or more of his employees. However, if the insurance policy, trust or

fund provides other benefits in addition to accident or health, § 106 applies only to the portion of the contributions allocable to accident or health benefits.

Coverage provided under an accident and health plan to former employees and their spouses and dependents is excludable from gross income under § 106. See Rev. Rul. 62-199, 1962-2 C.B. 32; Rev. Rul. 82-196, 1982-2 C.B. 53.

Section 105(a) provides that, except as otherwise provided in § 105, amounts received by an employee through accident or health insurance for personal injuries or sickness shall be included in gross income to the extent such amounts (1) are attributable to contributions by the employer which were not includible in the gross income of the employee, or (2) are paid by the employer.

Section 105(b) provides that except in the case of amounts attributable to (and not in excess of) deductions allowed under § 213 (relating to medical expenses) for any prior taxable year, gross income does not include amounts referred to in subsection (a) if such amounts are paid, directly or indirectly, to the taxpayer to reimburse the taxpayer for expenses incurred by him for the medical care (as defined in § 213(d)) of the taxpayer, his spouse, and his dependents (as defined in § 152 of the Code).

Section 301.7701-4(a) of the Procedure and Administration regulations provides that, in general, an arrangement will be treated as a trust if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit. If an entity has both associates and a business purpose, it cannot be classified as a trust for federal income tax purposes.

Section 6012(a)(4) provides, in general, that every trust having for the taxable year any taxable income, or having gross income of \$600 or over, regardless of the amount of taxable income, shall make a return with respect to income taxes under subtitle A.

Based on the information submitted and representations made, we conclude as follows:

(1) The income of Trust is derived from the exercise of an essential governmental function and will accrue to the political subdivision of a state for purposes of § 115(1). Consequently, we rule that Trust's income is excludable from gross income under § 115(1) of the Code.

(2) Trust is classified as a trust for federal income tax purposes under § 301.7701-4(a). Accordingly, no annual income tax return must be filed by Trust pursuant to § 6012(a)(4) because any income realized by Trust is excluded from gross income under § 115(1).

(3) Contributions paid to Plan and payments made from Plan which are used exclusively to pay for the accident or health coverage of retired employees, their spouses and dependents (as defined in § 152 of the Code) are excludable from the gross income of retired employees and retired employees' spouses and dependents under §§ 106 and 105(b) of the Code.

No opinion is expressed concerning the Federal tax consequences of Plan and Trust under any other provision of the Code other than those specifically stated herein. This ruling is directed only to the Taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Harry Beker
Chief, Health and Welfare Branch
Office of Division Counsel/Associate
Chief Counsel
(Tax Exempt & Government Entities)